



Pension Benefit Guaranty Corporation
1200 K Street, N.W., Washington, D.C. 20005-4026

Office of the Director

Via Electronic Mail & USPS

The Honorable Kevin de León
State Capitol, Room 5108
Sacramento, CA 95814

Mr. Grant Boyken
California Secure Choice Retirement Savings Program
915 Capitol Mall, Room 110
Sacramento, CA 95814

William Sokol, Esq.
Weinberg, Roger & Rosenfeld
1001 Marina Village Parkway, Suite 200
Alameda, CA 94501

Re: Secure Choice RFI # 13-01

Dear Senator de Leon, and Messrs. Boyken and Sokol:

At your request, PBGC is providing technical assistance and information to you and the California's Secure Choice Investment Board as you consider possible designs for the California Secure Choice Program (CSCP) legislated by the State's Secure Choice Retirement Savings Act (CSCA).

You asked that we respond to the RFI. That RFI raises many questions. If helpful, in the future we can provide assistance on other issues, but this letter is intended only to provide some of the information you requested concerning Question 1 on Plan Structure:

What type of plan structure would you recommend to best meet the statutory goals and objectives¹ for the Program, which include simplicity, ease of administration for

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- 1** The primary goals and objectives of the Program include the following:
1. Create a *self-sufficient retirement program, with minimal start-up and ongoing costs, for the estimated 6.3 million California workers who currently lack access to workplace retirement savings plans.*
 2. Establish a *process that makes it easy for employers to facilitate employee enrollment* in the Program with minimal and simple work for employers.
 3. *Maximize worker participation while providing a simple opt-out method* for employees who choose not to participate.
 4. Make appropriate investments for Program participants that *protect principal and offer growth opportunities.*

employers, preservation of principal and portability of benefits (e.g., a pooled fund with guaranteed interest credited to individual accounts on a regular basis that utilizes a gain and loss reserve? Individually held IRA-type accounts with a variety of funds from which participants could choose? Something else altogether?)

In the RFI, you noted that “innovation and creative ideas are highly encouraged”. In meetings with PBGC, you asked that we provide information on possible alternatives to the present design incorporated in CSCA, so we have focused on those possibilities. We developed two different approaches that the Board could consider to achieve its goal of expanding retirement coverage for California’s private-sector workers.²

Alternative 1 would enable CSCP to offer a defined benefit multiple-employer plan to provide a stable retirement benefit, with low and predictable costs, and limited employer responsibilities and exposure to liability, while retaining some of the protections that ERISA provides. (Employers would retain the ability to participate through CSCP in a non-ERISA option if they chose.) Alternative 2 would have CSCP offer retirement products such as annuities outside of ERISA through a state-sponsored entity such as a credit union or bank.

In both cases, an employer’s role could be limited largely to making initial decisions about how to enroll in CSCP and making payroll deductions, and with Alternative 1, decisions about the plan’s governance.

Approach 1: A Hybrid Pension with Some ERISA Protections

CSCA, as enacted, was intended to operate outside the legal framework of ERISA. The reasons for this approach are understandable: the small businesses that would be a major participant in CSCP do not wish to take on either the legal responsibility or the extensive regulatory compliance obligations that ERISA requires.

Nonetheless, an ERISA plan would offer many benefits and protections to the millions of employees that CSCP is intended to help (and that participants in the State of California’s plans also enjoy):

- The least possible burden on those who have the least expertise and time – individual workers;
- The lower risk, lower fees and higher return that comes from professional management, without the marketing and other costs of individual retirement accounts;

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5. Ensure that Program participants have *portable benefits and minimize “leakage”* to accumulate sufficient savings. “Leakage” refers to the early withdrawal of money from a retirement plan by the account holder before their retirement.
 6. In the long-term, facilitate the conversion of retirement savings to *a reliable and lifelong stream of income* to supplement Social Security.

² PBGC’s mandate under ERISA charges the agency “to encourage the continuation and maintenance of voluntary private pension plans.” However, PBGC is not opining on the merits or recommending these approaches; to our knowledge neither the Administration nor any federal agency has taken a position on CSCA. The information in this letter is provided at your request solely to present alternative technical approaches that the Board may consider for further analysis.

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- The security of having lifetime income, providing reassurance that retirees and their spouses won't end up outliving their savings – without having to undergo a physical exam or endure high-pressure sales pitches.
- Last, we should note that ERISA defined benefit plans are insured by PBGC.

As an agency created by ERISA to protect workers and retirees, we have worked to develop an approach that incorporates the protections of ERISA *without* imposing extensive legal and regulatory requirements on small businesses. Fortunately, ERISA has, since its inception, included just such an approach – multiple employer plans.

Multiple employer plan (“MEPs”) have existed for decades; the form pre-dates ERISA and was incorporated into ERISA. A MEP is established or maintained by two or more employers.³ Multiple employer plans are operated by the YWCA, rural electrical and agricultural cooperatives, the Girl Scouts of America, United Way agencies, and other organizations.

This plan design has many advantages over an individual IRA.

- Participants would generally accumulate greater benefits in this structure than under an individual IRA structure, because of lower marketing and administration fees and lower annuity purchase group rates.
- A defined benefit MEP can provide retirement benefits to those with a short career in the workforce due to disability. It is generally much easier to provide continued accrual during the period of disability and to integrate benefits with State and federal disability programs within the context of a defined benefit program than within the context of a defined contribution plan or IRA.
- The defined benefit Qualified Joint and Survivor rules applicable to these plans provide for default selection of a secure annuity benefit for the lifetime of the participant and spouse, with well-defined rules for election that have been tested and refined over decades.

Benefits Structure: The requirement that CSCP must be designed so that neither the State of California nor individual employers retains financial risk limits the kinds of benefits that the program may offer. Nonetheless, CSC could offer a range of benefit programs that provide for both the lifetime income and the safer, higher returns that are in the program's goals.

- *Hybrid Benefits: Market Participation with a Guarantee Against Losses* One possibility would be a hybrid plan with benefits dependent on market returns, but with a guarantee that funds kept for some years will achieve a minimum rate of return or at least a guarantee against losses of principal.⁴ Like an IRA, each person would have an individual account balance and amount of the account balance could be based on actual results; however there

³ Multiple employer plans are often confused with the more widely-known “multiemployer plans.” Multiemployer plans are established by labor agreements between unions and employers. *Multiple* employer plans are offered by groups of employers without any required union agreement or involvement.

⁴ The choice of plan design necessarily affects the nature of the investments undertaken by CSCP. See below.

would be two important differences: the investment results would be those achieved by professional pension fund investment managers (which have historically averaged about 1% per year better than the results obtained via IRA's).

Furthermore -- unlike with IRAs -- the CSCP could provide *additional protection against market collapse*, with a guarantee that funds kept in the plan for a set number of years would not lose any value, or be credited with a guaranteed minimum cumulative rate of return, say 2%.

- *Guarantee of Lifetime Income* A hybrid design could, by default, convert an account balance entirely or partially into a joint and survivor annuity. As an alternative, CSC could immediately convert part or all contributions to annuities, rather than waiting until retirement. In either case, annuities would have far more attractive terms than would be available to individuals. Their rates would reflect group purchasing power and group rating and the avoidance of individual sales commissions or other marketing fees.

Funding and employee participation: MEP funding could come from employee contributions deducted from each employee's pre-tax pay, and would be tax-deductible to the employer. Each employee would be given a one-time choice to opt out of participation in the MEP.⁵

Optional Employer Participation: One benefit of the MEP structure is that it could be designed to give employers the choice of making additional contributions, so long as they complied with the Internal Revenue Code's requirements.⁶

Governance & Oversight: To qualify as a MEP, the plan should have a governance structure (sponsor) composed of a private-sector association, committee, board of trustees or other representative group appointed by the participating employers, rather than a third party with no connection to either the participating employers or employees. For purposes of state oversight, the governing board or committee also could include one or two members appointed by the State Treasurer. Subject to consideration of issues relating to ERISA preemption, the state might also provide enhanced consumer and anti-fraud protections.

Employer Obligations: A MEP is a single plan covering many employers, rather than an aggregate of separate plans each operated by a single employer, so MEPs eliminate some of the practical barriers to adoption of a defined benefit plan by small employers.⁷ Under ERISA, MEP employers do have some legal responsibilities, but the MEP could be designed to limit employers' fiduciary role to very limited participation in appointing, evaluating and removing the members of the board or association established to run the plan. That board would be responsible for investment of assets, benefit administration, actuarial and financial valuations,

⁵ While employee contributions to defined benefit pension plans for government workers are often tax deductible to the employee; they generally are not tax deductible for private sector workers unless the worker makes a one-time irrevocable election to join the plan, or alternatively participates in a small employer hybrid "DB/k" plan organized under Internal Revenue Code Section 414(x).

⁶ These include limits to prevent discrimination in favor of the highly paid. The plan would need to specify the additional contribution options it contemplates in the determination letter request it files with the IRS.

⁷ PBGC defines a multiple employer plan as "a single-employer plan maintained by two or more contributing sponsors" 29 C.F.R. § 4001.2.

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audits, calculation of any required contributions, amendment of the plan as needed, submission of reports to the ERISA agencies, and disclosures to plan participants. As a legal matter, employers that withdraw from an MEP can be subject to withdrawal liability; however this prospect can be eliminated as a practical possibility by establishing the benefits as variable annuities, in which the benefit amount for a participant is tied to the market return on plan assets and/or via an insurance contract.

Administration: A MEP could be administered as a separate trust by CALPERS, CALSTRS, or by a private investment-management firm using their existing staff, collection mechanisms, and much of their IT infrastructure, with changes primarily to reflect any benefit provisions not currently offered.

CSCP Investment Practices MEPs can use and benefit from the returns achieved by professional pension investment managers of the kind already retained by CALPERS and CALSTRS. However, in order to eliminate risks arising from a floor or minimum guarantee, CSCP would need either to enter hedging agreements or to purchase annuities or an insurance contract (all of these approaches are already available in the private market). Alternatively, the funds could use their size and investment expertise to hedge any risks within a legislatively defined risk tolerance.

Legal Considerations: There are, of course, many legal issues inherent in the design of any retirement plan. Here we note a few of the more important ones.

Relationship between Employers, the CSCP, and the State of California CSCA already requires that there be no financial obligation on the State of California arising from the creation of CSCP. ERISA would impose additional requirements. It requires that the sponsor of a MEP be a group or association of employers.⁸ The U.S. Department of Labor (DOL), which interprets these provisions, goes further: DOL has for many years required that the group of employers must also have a “genuine organizational relationship” or “affinity” beyond having a common interest in providing quality retirement benefits.⁹ Examples of this affinity are businesses in a common industry or geographic area; DOL might conclude that businesses within California could meet this geographic test. California could design a MEP that assigned plan governance to a representative group appointed by the participating employers. In any event, the arrangement would need to be discussed with and approved by DOL.

Allowing California to Require Employers to Facilitate CSCP Under Federal law, ERISA prevents states from compelling participation in an ERISA plan. However, under the Ninth Circuit’s decision upholding San Francisco’s health-care ordinance in *Golden Gate Restaurant Ass’n v. City and County of San Francisco*, 546 F.3d 639 (9th Cir. 2008), it appears that a state

⁸ The state would need to limit its participation in sponsorship to having a few members of the plan trustees. See ERISA § 3(2)(A) defining “employee pension benefit plan,” ERISA § 3(5) defining “employer,” and ERISA § 3(16) defining “plan sponsor.”

⁹ See DOL Advisory Opinion 2012-04A (May 25, 2012). Such a relationship is established by showing an “employment based common nexus or other genuine organizational relationship that is unrelated to the provision of benefits. . . .” *Id.* at *11. ERISA practitioners have suggested that DOL should interpret ERISA more broadly to allow establishment of more multiple employer plans. See, e.g., *Journal of Pension Benefits*, “Multiple Employer Plans: An ERISA Enigma” (S. Derrin Watson, Winter 2012).

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can compel employers to undertake some actions *if* the range of employer options includes actions not covered by ERISA¹⁰. Under this decision, it appears that California could require those employers that do not otherwise offer retirement coverage to participate in an ERISA plan as the default option, so long as there is also a non-ERISA option. Employees would have the choice to opt out of a non-ERISA option as well.

Non-ERISA Option: To meet this requirement, California could allow employers who do not wish to participate in a MEP instead to participate in a non-ERISA program. There are many possibilities that are consistent with the goals of CSCA. For example, CSCA could allow a payroll deduction arrangement that purchases annuities at group rates. While such annuity purchases would not be deductible by the employee, they would enable employees to obtain group rates and dollar-cost average the purchase of annuities over time. The State could use its insurance regulatory powers to specify benefit provisions that would apply to annuities purchased through the program, such as a minimum rate of return guarantee and a requirement that benefits be paid as an annuity for the lifetime of the employee and 50% of the annuity to her surviving spouse.

Alternative 2: Offering Retirement Products via a State-Sponsored Credit Union, Bank, or Exchange

California could establish a state-sponsored umbrella organization to provide retirement products to employees of small employers that do not sponsor a retirement plan. The state could potentially structure this entity as a credit union, bank, insurer, or as an exchange.

Benefits at Retirement: The state-sponsored organization would offer individual savings products, such as IRAs and Individual Retirement Annuities, through affiliation with insurers providing access to annuity products.

The organization would have broad ability to define the range and composition of products it offers. For example, to ensure some lifetime income security, there could be a minimum annuity investment requirement (e.g., at least 50% of funds would be deferred annuities payable at retirement). Since these could be group-rated annuities (not based on a particular individual's health or life expectancy) and they would enjoy large economies of scale, reduced distribution costs, and virtually no marketing costs, this approach would significantly increase the value of annuities compared to currently available products.

This structure would not permit the same guarantee of value at retirement as the DB-MEP discussed above, but would provide some retirement security for private-sector employees that currently have little, at lower cost than would otherwise be available.

The entity could also offer a range of other products, such as mutual funds, target date funds or balanced growth funds. It could reduce marketing costs and increase returns to participants by having a competition among providers or products prior to selection of the range of CSCP offerings.

¹⁰ The existence of this non-ERISA option could satisfy one of the factors that the Ninth Circuit found important in holding that San Francisco's health-care ordinance was not preempted by ERISA – that the government give employers a meaningful alternative to participation in an ERISA plan.

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Governance and Administration: California could form a credit union, a credit cooperative, or a state-regulated bank or other financial organization, through which retirement products would be offered.

Credit unions generally can define their field of membership broadly. California could require chartered credit unions to provide annuity products that comply with regulations set forth by its insurance department, setting up additional regulatory authority for the department to monitor annuities that are eligible for sale by the chartered entity.

Alternatively, California could offer products through an exchange, either by expanding the state's health-insurance exchange to cover annuity products or by creating a free-standing annuity exchange. A combined exchange may provide options for synergy in design and regulation of the products offered. It would also have the benefit of offering one-stop shopping for citizens of the state.

Annuity exchanges or marketplaces would be similar in structure to the insurance exchanges and marketplaces established in states with mandated health insurance, such as Massachusetts and Connecticut. The exchanges would not themselves be annuity companies. Instead, they would select the annuity companies that are allowed to participate in the exchange. Annuity exchanges could help annuity companies (a) comply with consumer protection and other provisions of the law, (b) compete in cost-efficient ways, and (c) expand retirement coverage to more people. They could also promote transparency in the employees' selection process while reducing complexity. The exchanges should produce economies of scale that reduce the cost of purchasing an annuity. An annuity exchange could be structured to allow employees to "dollar cost average" their purchase of annuities over long periods of time through payroll deduction.

The exchanges could also be vehicles for IRA holders to purchase annuities -- either on a payroll-period basis, using an IRA as the conduit, or on an employment-termination basis -- so that individuals could obtain, via a state-sponsored platform, quotes on uniformly defined high-quality annuities. Many large 401(k) plans have adopted a similar platform to allow participants to select an annuity upon retirement. This form of the exchange would extend that type of platform to retirees of small private-sector plans, and provide a model for the operation of a regulated exchange for comparison with those exchanges currently available.

Legal Considerations: As long there is no employer involvement, a state-sponsored credit union, bank, or exchange should not be treated as an ERISA-covered plan.¹¹ The state could regulate operations under its insurance, banking, or other laws, and federal regulations could also apply (e.g., for FDIC-insured state banks).¹²

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In closing, we should note that these are approaches that will require careful study before the Board makes a decision on its final plan for CSCP. Design of retirement programs is necessarily highly complex. It requires a combination of expertises, including knowledge of human

¹¹ See ERISA § 3(2)(A) (defining "employee pension benefit plan" as any plan, fund, or program . . . established or maintained by an employer or by an employee organization, or by both").

¹² See ERISA § 514(b)(2)(A) (carving out from ERISA preemption state laws regulating insurance, banking, or securities).

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services, finance, benefits operation, law, and understanding of the economics of businesses and the personal financial resources of individuals. As a result of its programs, PBGC has many of these expertises, but we have not undertaken the months of careful work that will be necessary.

As the Board considers its many options, PBGC remains available to lend its expertises and provide additional information and technical assistance. If you wish to follow up, please contact Karen Morris at 202-326-4020, ext. 3074, or at Morris.Karen@PBGC.gov.

Sincerely,



Joshua Gotbaum
Director